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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

LAMPF, PLEVA, LIPKIND, PRUPIS & PETIGROW,
Petitioner,

v.

JOHN GILBERTSON, *et al.*,
Respondents.

On Writ of Certiorari to the United States
Court of Appeals for the Ninth Circuit

BRIEF OF SECURITIES INDUSTRY ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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BRIEF OF SECURITIES INDUSTRY ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

Preliminary Statement

Pursuant to Rule 37 of this Court and with consent of the parties, the Securities Industry Association ("SIA") submits this brief as amicus curiae in support of Petitioner.[1]

This case presents important issues not previously considered by the Court concerning the appropriate statute of limitations to govern judicially implied causes of action under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5

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[1] Written consents signed by all parties have been filed with the Clerk's office.

thereunder, 17 C.F.R. 240.10b-5. The principal issue is whether the limitations period for 10b-5 actions should be borrowed from an analogous state statute, as the court below concluded, or whether 10b-5 claims should be governed by the federal limitations period applicable to virtually all of the express causes of action under the federal securities laws — one year from the date of discovery but in no event longer than three years from the violation.

A further issue, which was not raised below but which we believe may be presented by the Securities and Exchange Commission as amicus curiae, is whether the five-year statute of limitations applicable to actions under the Insider Trading and Securities Fraud Enforcement Act of 1988, 15 U.S.C. § 78t-1 ("ITSFEA"), is a better federal alternative than the one-year/three-year limitations period.

Interest of Amicus Curiae

The Securities Industry Association is the principal trade association of the securities industry. Its members include approximately six hundred securities firms in the United States and Canada. Its membership is responsible for over ninety percent of the securities business conducted in this country. SIA's members serve securities investors of every size and type and perform the complete spectrum of professional securities activities, including retail and institutional brokerage, over-the-counter market-making, underwriting and other investment banking activities, money management, and investment advisory services.

SIA is generally recognized as a spokesman for the securities industry in general and the broker-dealer community in particular. A major function of SIA is to address legislative and regulatory matters affecting the securities industry on the national and state levels.

SIA has a substantial interest in this Court's determination of the limitations period applicable to 10b-5 actions. The current practice of borrowing variant state limitations periods makes it impossible for securities professionals to determine their rights with any degree of certainty. Moreover, tremendous expense is incurred by SIA members in litigation over the choice of an appropriate state limitations period.

The adoption of a uniform federal rule will remove the uncertainty and needless expense that has long haunted the securities industry in 10b-5 litigation.

SIA is also concerned with the SEC's proposal that the five-year ITSFEA limitations period be adopted for 10b-5 actions rather than the one-year/three-year rule. Longer limitations periods severely prejudice defendants by forcing them to litigate stale claims where memories are fuzzy and evidence is lost or misplaced. Protracted periods of potential exposure also make it easier for plaintiffs to speculate at the risk of the seller of securities by waiting to see if the market causes the securities to increase or decrease in value. The legislative history of the 1934 enactments clearly reflects a Congressional preference for a limitations period that balances the competing considerations of investor protection on the one hand with prompt and certain resolution of securities disputes on the other. The one-year/three-year scheme was specifically designed to fulfill these objectives; the five-year insider trading provision was not.

SUMMARY OF ARGUMENT

Because private actions under Rule 10b-5 are a judicial creation, there is no express statute of limitations for such claims. Accordingly, federal courts must "absorb" a statute of limitations for Rule 10b-5 from elsewhere in the law. Until recently, most courts routinely borrowed an analogous state limitations period. This practice has produced chaos. The use of variant state limitations periods creates differing time limits for similarly situated individuals asserting the same federal cause of action, encourages forum shopping, fosters expensive and unnecessary litigation, and runs directly counter to express Congressional intent to create a uniform, federal system of securities litigation and to assure a period of repose against stale claims. Almost unanimously, commentators have condemned the use of state law and have advocated adoption of a uniform federal statute of limitations.

In *DelCostello v. International Brotherhood of Teamsters*, 462 U.S. 151, 172 (1983), and *Agency Holding Corp. v. Malley-Duff & Associates*, 483 U.S. 143, 148 (1987), the Court held that a federal claim that lacks a statute of limitations should be governed by a federal limitations period if it provides "a closer analogy than available state statutes" and if "the federal policies at stake and the practicalities of litigation make that rule a significantly more appropriate vehicle for interstitial lawmaking." The one-year/three-year limitations period applicable to virtually all express claims under the federal securities laws satisfies this standard. Section 10(b) and the express causes of action governed by the one-year/three-year rule are part of the same legislative scheme, created by Congress at the same time, with the same objectives, to remedy the same types of injury. Additionally, application of a federal limitations period provides for uniformity and certainty, eliminates forum shopping, avoids expensive litigation and more closely reflects Congressional intent. To date three circuits have adopted this federal rule for 10b-5 actions. *In re Data Access Systems Securities Litigation*, 843 F.2d 1537 (3d Cir.) (en banc), *cert. denied*, 488 U.S. 849 (1988); *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385 (7th Cir. 1990), *petition for cert. filed*, 59 U.S.L.W. 3278 (U.S.

September 26, 1990) (No. 90-526); *Ceres Partners v. GEL Associates*, __ F.2d __, No. 89-7666 (2d Cir. Nov. 8, 1990) (1990 WL 171509).[2]

The one-year/three-year provision is a far better federal alternative than the five-year limitations period found in ITSFEA. The express causes of action created in the 1933 and 1934 enactments bear a much closer similarity in purpose and structure to Rule 10b-5 than does the atypical violation prohibited by ITSFEA. Moreover, the one-year/three-year rule reflects deliberate and careful balancing by Congress of the competing policies of investor protection and repose.

In contrast, the five-year limitations period in ITSFEA reflects no balancing whatsoever of the competing interests but was simply copied from the limitations provision contained in a predecessor statute which, in turn, was drawn from the criminal catchall statute of limitations. No court has adopted the ITSFEA five-year provision and the only two appellate courts that have considered this alternative (*Short* and *Ceres*) have rejected it.

[2] Those circuits declining to adopt a federal limitations period, including the Ninth Circuit, have done so solely on the basis of *stare decisis* rather than as a result of considered analysis of the alternatives. *See* discussion, *post*, at 13.

ARGUMENT

RULE 10B-5 CLAIMS SHOULD BE GOVERNED BY THE STATUTE OF LIMITATIONS IMPOSED ON EXPRESS CAUSES OF ACTION UNDER THE FEDERAL SECURITIES LAWS, WHICH REQUIRES THAT AN ACTION MUST BE BROUGHT WITHIN ONE YEAR OF DISCOVERY AND WITHIN THREE YEARS OF THE VIOLATION.

When Congress enacted the Securities Exchange Act of 1934, it created, along with Section 10(b), several express private rights of action. *See* § 9(e), 15 U.S.C. § 78i(e) (manipulation of security prices); §18(c), 15 U.S.C. § 78r(c) (liability for misleading statements in any application, report, or filed document); § 29(b), 15 U.S.C. § 78cc(b) (voiding contracts in violation of the Act) (added in 1938). Each of these express, Congressionally-ordained causes of action carries a limitations period of one year from the date of discovery and a maximum of three years from the date of the violation. Section 9(e), 15 U.S.C. § 78i(e), is typical: "No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation."[3]

At the same time that Congress passed the original 1934 Act, it also reduced the limitations period applicable to claims under the Securities Act of 1933 to conform with the one-year/three-year scheme being imbedded into the 1934 Act. *See* 15 U.S.C. § 77m. The original prescriptive period for private actions under the 1933 Act had been two years from the date of discovery but no more than ten years from the date of the violation. *See* 48 Stat. 84 (1933).

No statute of limitations was provided for Section 10(b) claims because Congress did not create any private cause of action under that

[3] Section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b), sets a two-year period for initiating litigation. Section 16(b) is a strict liability provision under which an insider's short-swing profits can be recovered by the corporation regardless of the intent or knowledge of the insider, and is thus readily distinguishable from the other provisions of the Act. *See* discussion in *Ceres*, WL 171509 at 15.

provision. Such a right is, in the words of Judge Aldisert, "a genie sired solely by the judiciary." *Data Access*, 843 F.2d at 1547. *See Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971) ("It is now established that a private right of action is implied under 10(b)"). The question thus presented is what limitations period is most appropriate for this "genie" extrapolated from the 1934 Act.

A. The Court Should Apply a Uniform Federal Limitations Period to 10b-5 Actions Rather than Borrowing State Law.

Until recently, most courts borrowed a limitations period found in an analogous state statute. This practice has resulted in a body of law as confused and unwieldy as any developed in the federal courts. Different limitations periods ranging anywhere from one to six years can apply to similarly situated parties asserting the very same federal cause of action. *Compare Data Controls North, Inc. v. Financial Corp. of America, Inc.*, 688 F.Supp. 1047, 1050 (D. Md. 1988), *aff'd mem.*, 875 F.2d 314 (4th Cir. 1989) (using Maryland's one-year blue sky statute of limitations) *with Mercer v. Jaffe, Snider, Raitt & Heuer*, 713 F.Supp. 1019, 1026 (W.D. Mich. 1989) (applying Michigan's six-year limitations period for fraud). Even within a given circuit, limitations periods vary substantially in length and courts borrow different types of statutes in different states. *Compare Shelter Mutual Ins. Co. v. Public Water Supply Dist. No. 7*, 569 F.Supp. 310, 312 (E.D. Mo. 1983), *aff'd*, 747 F.2d 1195 (8th Cir. 1984) (utilizing Missouri's two-year blue sky statutory limitations period) *with Rude v. Campbell Square, Inc.*, 411 F.Supp. 1040, 1048 (D.S.D. 1976) (borrowing South Dakota's six-year limitations period for common-law fraud). Forum shopping is thus encouraged as plaintiffs search for the states with the most lenient time requirements. Defendants have no way of predicting which rule will govern a particular dispute until an action is actually filed and a forum determined.

Predictability is further hindered by application of the doctrine of "equitable tolling," which means that the state's limitations period may not begin to run until the date when the wrongdoing is actually

discovered or "should have been" discovered. *See, e.g., Vanderboom v. Sexton*, 422 F.2d 1233, 1240 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970). The uncertainty created by equitable tolling also significantly diminishes the likelihood of a disposition of the limitations issue on summary judgment and provides lower courts, like the Ninth Circuit here, an opportunity to implement their antiquated philosophy that "summary disposition on the ground of the statute of limitations is discouraged." (Slip op. at 4.)

The state-law borrowing approach is most unpredictable where the plaintiffs reside in several different states, as is often the situation in consolidated or class actions. Even though all claims may spring from the same operative facts, courts will frequently apply a different limitations period to each plaintiff, with the indefensible result that the claims of some plaintiffs may be time-barred while those of others are not. *See, e.g., Kronfeld v. Advest, Inc.*, 675 F.Supp. 1449, 1457-58 & n.21 (S.D.N.Y. 1987) (district court applied 26 separate statutes of limitations); *In re National Student Marketing Litigation*, Fed. Sec. L. Rep. ¶ 97,926 (D.D.C. March 26, 1981) (noting possible applicability of 34 different states' statutes of limitation in class action). *See Ceres*, WL 171509 at 3 ("Indeed, there is no theoretical reason that residents of all 50 states could not be joined in a single suit or represented in a class action, with the result that more than 50 not-particularly-appropriate state statutes could provide the sources for determining whether the respective claims of otherwise identically situated plaintiffs were time-barred").

Other courts choose a single limitations period, drawn from the state with the "most significant contacts" to the action, and apply it to all class members. *State Teachers Retirement Board v. Fluor Corp.*, 80 F.R.D. 142, 145 (S.D.N.Y. 1978). At least one court has eschewed logic in favor of simplicity by using the statute of limitations of the forum state for all class members — even while admitting that this produces the "inconceivable" result of reviving the "dead and breathless" claims of non-resident class members who would have been barred had they brought suit in their home state. *Pinney v. Edward D. Jones & Co.*, 735 F.Supp. 915, 917 (W.D. Ark. 1990), *interlocutory appeal pending*, No. 90-1680WA (8th Cir.).

Courts and commentators alike have condemned the current state of the law. In 1986 a special Task Force of the American Bar Association studying limitations periods for 10b-5 actions summarized the prevailing view:

> "Such disarray serves no public purpose. This uncertainty and lack of uniformity promote forum shopping by plaintiffs and result in wholly unjustified disparities in the rights of parties litigating identical claims in different states. Neither plaintiffs nor defendants can determine their rights with any certainty. Vast amounts of judicial time and attorneys' fees are wasted."

Report of the Task Force on Statute of Limitations for Implied Actions, 41 BUS. LAW. 645, 647 (1986) ("ABA Task Force Report"). Judge Easterbrook colorfully referred to this situation as "one tottering parapet of a ramshackle edifice." *Norris v. Wirtz*, 818 F.2d 1329, 1332 (7th Cir.), *cert. denied*, 484 U.S. 943 (1987). One district judge more bluntly described it as an area of law that "simply 'makes no sense.' " *Pinney v. Edward D. Jones & Co.*, 915 F.Supp. at 916.

Regrettably, the chaos that has resulted was totally avoidable. Courts just as easily could have chosen a uniform federal limitations statute, drawn from Section 10(b)'s sister provisions in the 1933 and 1934 Acts, to govern 10b-5 actions. As Justice Brennan pointed out in his concurring opinion in *McAllister v. Magnolia Petroleum Co.*, 357 U.S. 221, 228-29 (1958), the rationale of early Court decisions sanctioning the use of state limitations periods was not that state statutes should automatically be used, but rather that where a state statute *is the only one available*, the choice is between a state limitations period and none at all:

> "[T]he considerations which in *Campbell v. Haverhill*, [155 U.S. 610 (1895)] and *Cope v. Anderson*, [331 U.S. 461 (1947)] prompted resort to the state statutes do not apply at all here. Those cases represented intensely practical solutions to a practical problem in the administration of justice. *In the absence of any comparable federal statute of limitations* which might be applied, the Court had four choices: (1) No period of limitations

at all; (2) an arbitrary period applicable in all like cases; (3) the flexible but uncertain doctrine of laches; and (4) state statutes of limitations. *The state statutes were chosen by default.*"[4]

Until recently, the federal option for 10b-5 actions was not utilized. Instead, aided by counsel's failure to urge otherwise, lower courts automatically used state limitations periods. "Federal courts are so accustomed to turning to state periods of limitations that we (and our colleagues in other circuits) did this on auto-pilot, without discussing whether something differentiated securities laws from other statutes." *Short*, 908 F.2d at 1387.

The consensus among courts and commentators is that the practice of borrowing state limitations periods for 10b-5 actions was a mistake. "[T]he courts missed a turn. Courts should have drawn the periods of limitations for the implied rights from the periods of limitations for the express rights." *Norris v. Wirtz*, 818 F.2d at 1333. *See also* Ruder & Cross, *Limitations on Civil Liability Under Rule 10b-5*, 1972 DUKE L.J. 1125, 1149 (1972) (the practice of borrowing state limitations periods for 10b-5 actions "must be judged as a mistake in application of principle"); Bloomenthal, *The Statute of Limitations and Rule 10b-5 Claims: A Study in Judicial Lassitude*, 60 U. COLO. L. REV. 235, 236 (1989) ("The history of this judicial travesty is replete with evidence of sloppy scholarship, the willingness of the courts to accept *dicta* without analysis, and the remarkable inefficiency of the federal judicial system in resolving disputed issues of federal law").

In *DelCostello* the Court finally put to rest the notion that federal courts were somehow "bound" by state law in determining the appropriate limitations period for federal claims. The Court held that a federal statute of limitations, § 10(b) of the NLRA, 29 U.S.C. § 160(b), should apply to hybrid duty-of-fair-representation claims under § 301 of the NLRA, which lacks an express limitations period. The Court noted that the choice of a time limit for a federal cause of action "is

[4] Emphasis ours here and throughout this brief except where otherwise noted. In *McAllister* the Court adopted a federal statute of limitations, applying a prescriptive period from the Jones Act to an action under maritime law to recover for unseaworthiness. *Id.* at 224.

itself a question of federal law," 462 U.S. at 159 n.13, and that state statutes of limitations are useful merely as a convenient method of "fashioning remedial details where Congress has not spoken," not because state law somehow controls. *Id.* at 159. The Court explained that federal courts have *always* been free to borrow federal limitations periods:

> "[W]hen a rule from elsewhere in federal law clearly provides a closer analogy than available state statutes, and when the federal policies at stake and the practicalities of litigation make that rule a significantly more appropriate vehicle for interstitial lawmaking, *we have not hesitated to turn away from state law*." *Id.* at 172.

The Court illustrated its point by reference to past cases such as *McAllister*, *Holmberg v. Armbrecht*, 327 U.S. 392 (1946), and *Occidental Life Insurance Co. v. EEOC*, 432 U.S. 355 (1977), in which it declined to borrow state statutes. 462 U.S. at 162-63.

In *Agency Holding Corp. v. Malley-Duff & Associates*, 483 U.S. 143 (1987), the *DelCostello* rationale was applied to determine the appropriate prescriptive period for civil actions brought pursuant to the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1964, which includes an express provision for civil liability but does not contain a limitations period. The Court was presented with an array of conflicting viewpoints akin to that which currently exists with respect to 10b-5 actions: federal judges had "not adopted a consistent approach to the problem of selecting the most appropriate statute of limitations," *id.* at 148; lower courts had "uniformly looked to state statutes of limitations," *id.* at 149; and commentators had lamented that the law was "confused, inconsistent and unpredictable." *Id.* at 148.

Agency Holding reaffirmed the appropriateness of borrowing federal limitations periods: "Although it has been suggested that federal courts always should apply the state statute of limitations most analogous to each individual case whenever a federal statute is silent on the proper limitations period, a clear majority of the Court rejected such a single path." *Id.* at 146 (citations omitted). Because of "the

similarities in purpose and structure between RICO and the Clayton Act [and] the clear legislative intent to pattern RICO's civil enforcement provision on the Clayton Act," *id.* at 152, the Clayton Act was deemed "a far closer analogy than any available state statute." *Id.* at 156. The Court also determined — in language especially apposite here — that the "federal policies at stake and the practicalities of litigation" strongly favored application of a federal rule:

> "As this case itself illustrates, RICO cases commonly involve interstate transactions, and conceivably the statute of limitations of several states could govern any given RICO claim. Indeed, some nexus to interstate or foreign commerce is required as a jurisdictional element of a civil RICO claim. . . . The multistate nature of RICO indicates the desirability of a uniform federal statute of limitations. With the possibility of multiple state limitations, the use of state statutes would present the danger of forum shopping and, at the very least, would 'virtually guarante[e] . . . complex and expensive litigation over what should be a straightforward matter.' "*Id.* at 153-54.

Following *Agency Holding*, three Courts of Appeals have abandoned the historical practice of borrowing state limitations periods for 10b-5 actions and have adopted the one-year/three-year rule applicable to most express causes of action under the federal securities laws. The Third Circuit in *Data Access* was the first to utilize the federal rule, followed by the Seventh Circuit in *Short* and the Second Circuit in *Ceres*.[5] The Eighth Circuit has stayed consideration of the issue pending the Court's decision in this case. *Pinney v. Edward D. Jones & Co.*, No. 90-1680WA (8th Cir. October 23, 1990). Two district courts have adopted the one-year/three-year federal scheme without waiting for authority from the circuit. *Robertson v. Deloitte, Haskins & Sells*, 732 F.Supp. 979, 985 (E.D. Ark. 1990); *Welch v. Cadre Capital*, 735 F.Supp. 467, 481-82 (D. Conn. 1989).

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[5] *Data Access* was an *en banc* decision. The opinion in *Short* was circulated to all judges in active service in the circuit and no judge voted to hear the case *en banc*. 908 F.2d at 1389. The *Ceres* opinion was also circulated to all active circuit judges. WL 171509 at 18.

Many of the lower federal courts that have declined to adopt a uniform limitations period, including the court below, have done so on the basis that they felt hemmed-in by circuit precedent. *See, e.g., Smith v. Duff & Phelps, Inc.*, 891 F.2d 1567, 1570 (11th Cir. 1990) ("one panel of the Court is not permitted to overrule a decision by a previous panel unless the Court overrules the earlier decision by an en banc proceeding"); *Bath v. Bushkin, Gaims, Gaines & Jonas*, 913 F.2d 817, 819 (10th Cir. 1990) ("district court is bound to follow the precedent of this circuit, regardless of its views concerning the advantages of the precedent of our sister circuits"); *Nesbit v. McNeil*, 896 F.2d 380, 384 (9th Cir. 1990) (declining to follow *Data Access* without consideration *en banc*).

The reasons supporting the adoption of a federal limitations period for 10b-5 actions are unassailable. The express causes of action created by Congress under the same statutory scheme provide a "far closer analogy," *Agency Holding*, 483 U.S. at 156, to Section 10(b) than any state alternatives. Judically-implied 10b-5 claims and the legislatively-created claims spring from the same common origin with the same objectives, to remedy the same type of injury. Section 10(b) was not just "patterned after" the express causes of action, *cf. Agency Holding*, 483 U.S. at 156; it was created as part of the very same legislation. It is hard to imagine a more "analogous" cause of action. *Cf. Blue Chip Stamps v. Manor Drug Stores*, 421 U.S 723, 741 (1975) (choices made by Congress with respect to the express terms written into the federal securities acts are entitled to great weight in fashioning the scope of remedies for implied actions under Section 10(b)).

The only reasonable interpretation of Congressional intent is that if Congress had created a private right to sue under Section 10(b), it would have used the same limitations period that it appended to the express causes of action that are part of the same legislative scheme. "Congress has spoken directly to the appropriate statute of limitations for [10b-5] litigation. . . ." *Short*, 908 F.2d at 1388. "Given Congress' enactment of specific periods of limitation for every private right of action that it expressly provided in the federal securities laws, we conclude that judicial selection of a uniform nationwide limitations

period is what Congress would have intended for private rights of action judicially implied under those laws." *Ceres*, WL 171509 at 3.

A federal limitations period better effectuates the federal policies at stake. The federal securities laws were enacted precisely because the securities markets were national in scope and no single state's laws were capable of regulating the nation's capital markets. *See* 15 U.S.C. § 78b ("[T]ransactions in securities as commonly conducted upon securities exchanges and over-the-counter markets *are affected with a national public interest* which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto. . . .") Application of differing limitations periods to similarly situated parties asserting the same right runs counter to this goal of federal uniformity. *Cf. Reves v. Ernst & Young*, __ U.S. __, 110 S.Ct. 945, 954 (1990) ("We are unpersuaded that Congress intended the Securities Acts to apply differently to the same transactions depending on the accident of which State's law happens to apply").

The use of diverse state limitations periods, coupled with application of the equitable tolling doctrine, frustrates the strong federal policy favoring repose of securities claims at a predictable time. The legislative history from 1934 reflects that certainty of repose against stale claims was one of the overriding concerns of Congress when it enacted the Exchange Act. *See Norris v. Wirtz*, 818 F.2d at 1332 ("The legislative history in 1934 makes it pellucid that Congress included statutes of repose because of fear that lingering liabilities would disrupt normal business and facilitate false claims"). Application of the one-year/three-year federal limitations period will ensure certainty as Congress intended.

The "practicalities of litigation" persuasively counsel against resort to state limitations periods for 10b-5 actions. The state-law borrowing approach plainly encourages forum shopping, a practice long disfavored by this Court. Moreover, since interstate commerce is a jurisdictional predicate for the application of Rule 10b-5, resort to state law virtually guarantees complex and expensive litigation over the choice of a limitations period. Adoption of a single federal statute of limitations will put an end to the inefficiency and chaos that has plagued courts and parties alike.

B. The One-Year/Three-Year Rule Is the Most Appropriate Federal Statute of Limitations To Govern Implied Private Rights of Action Under Section 10(b) of the 1934 Act.

The Securities and Exchange Commission agrees that adoption of a uniform federal limitations period for 10b-5 actions is preferable to the practice of borrowing state limitations periods. But the SEC has contended that a different federal limitations period — the five-year rule governing the insider trading prohibition in ITSFEA, 15 U.S.C. § 78t-1 — should be selected by the Court.[6] This alternative has not been adopted by any court and has been rejected by both Courts of Appeals that have considered the issue. *Short*, 908 F.2d at 1392; *Ceres*, WL 171509 at 6.

The express claims in the '33 and '34 Acts are much closer to Rule 10b-5 in "purpose and structure," *Agency Holding*, 483 U.S. at 152, than are ITSFEA claims. There is substantial overlap between the conduct covered by the express actions and that covered by implied actions under Rule 10b-5. *See Ceres*, WL 171509 at 14 (noting that Rule 10b-5 overlaps §§ 9(e) and 18(a) of the '34 Act and § 11 of the '33 Act); *Short*, 908 F.2d at 1390-91 (§§ 11 and 12 of the '33 Act cover the same offenses as § 10(b)). Indeed, Section 10(b) was purposely designed by Congress as a broad "catchall" category that would provide statutory authority for the Commission to add to the list of prohibited or regulated practices that were not specifically enumerated in other sections of the Acts. *See Stock Exchange Regulation: Hearings on H. R. 7852 and H. R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934), *reprinted in* 8 J. Ellenberger & E. Mahar, *Legislative History of the*

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[6] The SEC took this position in an amicus curiae brief filed in *Lebman v. Aktiebolaget Electrolux*, (U.S., No. 88-1114). *See* Brief for the United States as Amicus Curiae, filed June 6, 1989. The brief was submitted at the Court's request in connection with a petition for certiorari in *Lebman v. Aktiebolaget Electrolux*, 854 F.2d 1319 (5th Cir. 1988). Certiorari was eventually denied in *Lebman*, 109 S. Ct. 3214 (1989). We expect the SEC to take the same position in this case, although to date it has declined to reveal its intentions in this regard.

Securities Act of 1933 and Securities Exchange Act of 1934 (1973) (original section 9(c), which eventually became Section 10(b), "is a catchall clause to prevent manipulative devices .... The Commission should have the authority to deal with new manipulative devices"); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976) ("the catchall provision of § 10(b)" should be interpreted in accordance with the elements of an action under Section 9 of the '34 Act).

In contrast to the kinship between Rule 10b-5 and its sister provisions in the '33 and '34 Acts, ITSFEA is directed at an "atypical kind of violation." *Short*, 908 F.2d at 1392. It applies only to "purchasing or selling a security while in possession of material, nonpublic information" and affords a remedy solely to persons who "contemporaneously" purchased or sold "securities of the same class." 15 U.S.C. § 78t-1(a). Damages are limited to the wrongdoers' profit, § 78t-1(b)(1), rather than the plaintiffs' loss. The victims of this unique offense are usually strangers to the illicit conduct who are unaware that a violation has even occurred. Consideration of these factors led Judge Easterbrook in *Short* to reject the ITSFEA five-year rule for 10b-5 cases:

> "To select § 20A(b)(4) as the rule for *all* Rule 10b-5 actions, just because a five-year period has been deemed appropriate for one atypical kind of violation, would let the tail wag the dog. Congress did not say that § 20A applies to all cases under Rule 10b-5; it did not amend § 13 [of the 1933 Act, specifying a one-year/three-year period]; it limited the scope of § 20A(b)(4)'s statute of limitations to a particular and atypical kind of violation. Section 20A(b)(4) has been prescribed for inside trading cases; run-of-the-mine frauds under Rule 10b-5 should be governed by the statute in force when Rule 10b-5 came into being, the statute *designed for* the kind of conduct about which Short and most other 10b-5 plaintiffs complain: § 13 of the Securities Act of 1933." 908 F.2d at 1392 (emphasis in original).[7]

In *DelCostello*, 462 U.S. at 169, the Court recognized that the ultimate objective is to utilize that limitations period which is "actually designed to accommodate a balance of interests . . . similar to that at stake" for the federal claim at issue. The one-year/three-year rule fulfills this objective. The legislative history of the 1934 enactments reflects that this provision was the result of a deliberate attempt by Congress to "accommodate a balance" between investor protection and repose in securities fraud actions. Before they arrived at the present rule, Congress debated a host of other limitations schemes: two years from discovery with no cutoff; two years from discovery with a six-year maximum; no longer than two years from the violation; and no longer than three years from the violation.[8] *See also* Schulman,

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[7] If the goal is to select the limitations period that requires the shortest "leap into the realm of legislative judgments," as Justice Scalia suggested in his dissent in *Agency Holding*, 483 U.S. at 157, then the one-year/three-year rule is clearly a better choice than the five-year ITSFEA provision. Adoption of a limitations period that was enacted as part of the very same legislation as Section 10(b) plainly requires less of a legislative-type judgment by the judiciary than selection of a limitations period created more than fifty years later for a unique species of securities fraud.

[8] When the 1934 Act was initially introduced, the precursors to what eventually became Sections 9(e) and 18 contained a limitations period of two years from discovery of the violation, and no outer limit. S. 2693, 73d Cong., 2d Sess. §§ 8(e), 17(e) (1934), *reprinted in* 11 J. Ellenberger & E. Mahar, Item 34 at 20, 33; H.R. 7852, 73d Cong., 2d Sess. §§ 8(e), 17(e) (1934), *reprinted in* 10 J. Ellenberger & E. Mahar, Item 24 at 20, 33. A six-year maximum was added to the version of the bill that was reported out of the Senate Committee on Banking and Currency. S. 3420, 73d Cong., 2d Sess. §§ 9(e), 18(c) (1934), *reprinted in* 11 J. Ellenberger & E. Mahar, Item 37 at 23, 41. Thereafter, Senator Fletcher, the Chairman of the Senate Committee on Banking and Currency, introduced the "Fletcher Amendments" to the 1933 Act, which, as passed by the Senate, reduced the limitations periods in that Act from the initial two-year/ten-year formulation to one year from discovery and five years from the violation, and also amended the limitations period in the proposed 1934 Act to conform to the new, lower one-year/five-year limitations periods being proposed for actions under the 1933 Act. *See* 11 J.

(Footnote 8 continued on next page)

Statutes of Limitation in 10b-5 Actions: Complication Added to Confusion, 13 WAYNE L. REV. 635, 637 (1967) (statute of limitations provisions in securities acts were "the subject of deep and perhaps exaggerated congressional interest").

The one-year limitation period beginning with the date of discovery was "thoroughly discussed by the [Senate] committee," 78 CONG. REC. 8198 (1934) (statement of Sen. Walcott), and was characterized by a Senate floor leader and Conference Committee member as the result of an attempt to "agree upon something that would be just and fair to both sides." 78 CONG. REC. 8200 (1934) (statement of Sen. Byrnes). Senator Fletcher, who was chairman of the committee that drafted the Senate version of the bill, floor manager of the measure in the Senate and a member of the Conference Committee, explained that:

> "[T]he thought was that a man ought not to delay suit more than 1 year after he discovers the fraud. If he has been injured and finds that he has been injured, he ought to bring his action within a reasonable time, and we fix that time at 1 year." 78 CONG. REC. 8198 (1934).

(Footnote 8 continued from previous page)

Ellenberger & E. Mahar, Item 38; *see also* 78 CONG. REC. 8198 (1934) (Senator Fletcher explaining purpose of latter amendment to "chang[e] this provision, so as to make it conform to the Securities Act as we will eventually amend that act").

In the meantime, the House version of the 1934 Act had been reintroduced by Representative Rayburn first with a two-year limitations period measured from the date "the cause of action accrued," H.R. 8720, 73d Cong., 2d Sess. §§ 8(d), 17(c) (1934), *reprinted in* 10 J. Ellenberger & E. Mahar, Item 28 at 26, 43, and later containing a three-year absolute limitations period measured from "the violation," H.R. 9323, 73d Cong., 2d Sess. §§ 8(e), 17(c) (1934), *reprinted in* 10 J. Ellenberger & E. Mahar, Item 29 at 24, 40. It initially passed in the House in the latter form, *see* 10 J. Ellenberger & E. Mahar, Item 31. The Conference Committee borrowed a little from each version, applying the Senate's one-year-from-discovery provision and the House's three-year absolute cutoff to actions under Sections 9(e) and 18 of the new 1934 Act and applying them as well to the 1933 Act. H.R. Rep. No. 1838, 73d Cong., 2d Sess. (1934), *reprinted in* 5 J. Ellenberger & E. Mahar, Item 20 at 32,42.

As the Third Circuit noted in *Data Access*, "[a]fter the plaintiff has notice, there is a strong federal interest in requiring him to file suit quickly." 843 F.2d at 1546 (*quoting Roberts v. Magnetic Metals Co.*, 611 F.2d 450, 463 (3d Cir. 1979) (Seitz, C. J. dissenting)). But the five-year ITSFEA provision does not require any diligence upon discovery of the alleged wrongdoing. An investor can wait five years, regardless of when he discovers the alleged fraud, to file suit. The lack of any discovery rule fatally flaws the ITSFEA provision as a limitations period for 10b-5 actions. As Senator Barkley noted in the Senate debate on the '34 Act:

> "By putting in a limitation of 1 year after the discovery of the fraud, we are actually limiting the possibility of litigation . . . . [W]hen we say, 'Although you discovered the fraud within a month or within 6 months after it was committed, you have to bring suit within a year, or you cannot bring it at all,' we actually limit rather than encourage litigation. Otherwise, the man could go on until the end of 5 years, although he had known about the fraud all the time, and still bring his suit." 78 CONG. REC. 8199 (1934).

Cf. Burnett v. New York Central Railroad Co., 380 U.S. 424, 428 (1965) ("the courts ought to be relieved of the burden of trying stale claims when a plaintiff has slept on his rights").

Congress likewise had specific and well-considered reasons for adopting the definitive three-year cutoff. "It was understood that the three-year rule was to be absolute." *Norris*, 818 F.2d at 1332. *See, e.g.*, 78 CONG. REC. 10,186 (1934) (statement of Sen. Byrnes) ("[T]he amendments adopted today [reducing the ten-year absolute cut-off in the 1933 Act to three years] give greater assurance to the honest officials of a corporation . . . ."); 78 CONG. REC. 8198 (1934) (statement of Sen. Fletcher) (A person "ought to feel safe at some reasonable time that he will not be disturbed").

In contrast to the deliberate and careful balancing that went into creation of the one-year/three-year scheme, the ITSFEA five-year rule contained in § 20A(b)(4) reflects no balancing whatsoever of the

competing considerations relevant to securities fraud claims. The five-year provision actually originated in the Insider Trading Sanctions Act of 1984 ("ITSA"), 15 U.S.C. § 78u-1, which expanded the powers of the SEC to act against unlawful insider trading but did not provide for an express private right of action. Because the SEC was empowered to seek treble damages, which could involve potentially staggering sums, a five-year statute of limitations, drawn from the criminal law dealing with securities law violations, was added. *See* H.R. Rep. No. 355, 98th Cong., 2d Sess., *reprinted in* 1984 U.S. CODE CONG. & ADMIN. NEWS 2274, 2302.[9] The intended perimeters of this limitations period were strictly circumscribed. As the legislative history of ITSA explicitly states, "[t]he [five-year] limitation [period] is applicable *solely* to actions brought under this legislation." *Id.* at 2285.

In 1988, in the face of growing insider trading scandals, ITSA was amended and supplemented by ITSFEA, and an express private right of action was created. But *nowhere* in the history of the 1988 legislation is there *any* evidence that *any* consideration was given to the limitations provision, other than a passing, unadorned statement that the five-year period from ITSA would apply to ITSFEA. *See* 133 CONG. REC. S8247 (1987) (statement of Sen. Riegle); H.R. Rep. No. 910, 100th Cong., 2d Sess., *reprinted in* 1988 U.S. CODE CONG. & ADMIN. NEWS 6043, 6076. Thus, the reasons for adopting the five-year limitations period in ITSFEA were not even remotely related to the policy reasons exhaustively discussed by Congress in connection with the express remedies of the '33 and '34 Acts. *Cf. Agency Holding*, 483 U.S. at 155 (five-year federal criminal statute of limitations "does not reflect any congressional balancing of the competing equities unique to civil RICO actions or, indeed, any other federal civil remedy").

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[9] At the hearings on this proposed legislation, John Shad, then Chairman of the SEC, commented: "A five-year statute of limitations for penalty actions was added to the House bill. This conforms to the five-year statute of limitations for criminal violations of the Securities Exchange Act . . . ." *The Insider Trading Sanctions Act of 1983: Hearing on H.R. 559 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 98th Cong., 2d Sess. 28 (1984).

A longer, five-year period may be appropriate for ITSFEA given the "difficulties of ferreting out evidence sufficient to prosecute insider trading cases," *Ceres*, WL 171509 at 15, but it has no application to run-of-the-mill 10b-5 actions. "Prudent investors almost always can sniff out fraud (or enough smoke to justify litigation) within three years. Section 13 cuts off only the claims of the most trusting or somnolent — or the most wily, those who wanted to wait as long as possible." *Short*, 908 F.2d at 1392. As previously discussed, Congress specifically rejected limitations periods longer than three years, including a one-year/five-year limitations scheme, for all other express federal securities claims it created.[10]

Three years is well within the mainstream of legislative judgments concerning the appropriate length of prescriptive periods applicable to securities fraud actions. In addition to the one-year/three-year scheme found in the federal securities acts, the vast majority of the state legislatures have enacted limitary periods of three years or less. *See ABA Task Force Report*, 41 BUS. LAW. at 662-66 (all but seven at time of survey). Moreover, Section 606 of the Uniform Securities Act (1985) recommends application of the same one-year/three-year scheme found in the federal securities laws. The comment to that section indicates that the three-year period was considered to be on the long end of the spectrum: "There appears to be a split among the states today between using a two-year or three-year outside statute of limitation. The Committee opted for the longer three-year limit."

A longer limitations period increases the prejudice to defendants that inheres in stale claims. Securities claims are often "easier to advance than refute," *Norris v. Wirtz*, 818 F.2d at 1333. The longer litigation is delayed, the more difficult it is for a defendant to marshal evidence to defend himself. As this Court stated in *Burnett v. New York Central Railroad Co.*:

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[10] Imposition of an absolute three-year limitations bar on federal claims will not shut out investors who, through no fault of their own, have failed to discover what is genuinely a fraud. Aggrieved parties will still have the full panoply of state common-law claims from which to draw, including common-law fraud.

"Statutes of limitations are primarily designed to assure fairness to defendants. Such statutes 'promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared. The theory is that even if one has a just claim it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them.'" 380 U.S. at 428, *quoting Order of Railroad Telegraphers v. Railway Express Agency, Inc.*, 321 U.S. 342, 348-49 (1944).

The five-year ITSFEA limitations period conflicts with rules promulgated by the SEC governing the length of time that broker-dealers must keep and preserve essential books and records. The vast majority of such records, including those relevant to defense of a 10b-5 claim, are required to be kept no longer than three years. *See* Rules 17a-3 and 17a-4, 17 C.F.R. 240.17a-3 and 17 C.F.R. 240.17a-4. Broker-dealers who justifiably rely on these regulations may be unable to defend themselves properly if investors are allowed to wait five years before bringing suit.

A longer limitation period also makes it easier for a plaintiff to speculate at the risk of the seller of securities. An investor who thinks he has been defrauded can elect to see how his investment turns out before commencing litigation. Obviously, the longer the investor is allowed to wait, the greater the chance that any subsequent loss will be attributable to intervening market forces wholly unrelated to the initial wrongdoing. As the stock market becomes more volatile, the risk of such unforeseeable liability increases drastically. "Congress chose one year after discovery, and a cap of two additional years on tolling principles, in order to curtail the extent to which the securities laws permit recoveries based on the wisdom given by hindsight." *Short*, 908 F.2d at 1392. By contrast, damages under ITSFEA are limited to the profits of the violator and are not affected by subsequent fluctuations in the stock market.

Conclusion

For the reasons stated, the Court should hold that the statute of limitations applicable to judicially implied actions under Rule 10b-5 is the federal rule requiring an action to be brought within one year of discovery of the alleged fraud and in no event later than three years from the violation.

Respectfully submitted,

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